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FM AMEMBASSY MONTEVIDEO
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INFO RUCNMER/MERCOSUR COLLECTIVE
RHEHNSC/NSC WASHDC
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E.O. 12958: N/A
TAGS: ECON EFIN UY
SUBJECT: CENTRAL BANK PRESIDENT LAYS OUT GOU'S ECONOMIC POLICY CONSIDERATIONS

Ref A: 08 Montevideo 583
Ref B: 08 Montevideo 627
Ref C: 08 Montevideo 697
Ref D: Montevideo 74

SUMMARY

¶1. (SBU) SUMMARY: Central Bank President Mario Bergara told the Charge d'Affaires that Uruguay remains relatively well-positioned to confront the worldwide economic slowdown -- its banking sector remains healthy, consumer spending is solid, and its fiscal house is in order. While some in the business community have pleaded for greater government intervention, along the lines of stimulus packages seen in many other countries, the GOU sees this as a bad remedy for Uruguay and prefers to keep its economic policy arrows in the quiver for now. During the week of February 16, the GOU did access a USD 200 million loan from the Andean Development Corporation and arranged a USD 400 million line of credit with the World Bank. END SUMMARY.

BERGARA ASSESSES IMPACT ON THE ECONOMY

¶2. (SBU) In a meeting with the Charge on February 12, Central Bank President Mario Bergara discussed recent GOU economic policy decisions made in light of the global crisis and showed he was well aware of, and comfortable responding to, public debate over the GOU's strategy. Begara noted that GDP growth projections for 2009 remain positive, but the dramatic drop from approximately 10 percent growth in 2008 to expected 1-3 percent growth in 2009 is reverberating throughout the economy and hitting some specific sectors hard. Commodity prices had fallen, but remain at historically high levels similar to a year ago. Bergara noted that the total value of exports (of which commodities or commodity-based industrialized goods represent over 70 percent of total merchandise exports) remained constant; Uruguay is actually exporting a higher volume of goods at a lower price and to more diverse markets than in the past. He predicted that some affected sectors, such as leather upholstery for European-made luxury cars, would remain at the mercy of European and U.S. markets recovering in the future. However, the economy is general was relatively well-positioned to weather the global downturn.

NO STIMULUS PACKAGE FOR URUGUAY

¶3. (SBU) Bergara discussed comments made recently by some in the business community who have called for a stimulus package to help business and for the monetary policy to focus on competitiveness. The Central Bank recently raised its benchmark interest rate (from 7.75 percent to 10 percent) in order to fight inflation, while others in the region were lowering theirs. Bergara explained that,

since the Uruguayan economy is highly dollarized, the peso-denominated interest rate is not a key variable locally as in Brazil, where most debt is denominated in reales. Uruguay has a higher percentage of dollar-denominated debt and a more open economy, he added. He also pointed out that domestic consumption remains solid and that many Uruguayan consumers have recently begun buying more after four years of strong growth, a trend noted in holiday sales figures, new car sales and private investments. As the economy began to recover from the 2002 economic crisis, consumers initially paid down debts, were cautious with spending and saved more. As a final point, Bergara explained that an injection of liquidity, while a common prescription elsewhere, would be a bad plan for Uruguay. Such a measure would increase inflationary pressures, while noting that Uruguay has largely dodged the financial crisis due to its underdeveloped capital markets, so there has been no resulting loss of capital.

INFLATION VS. THE EXCHANGE RATE

¶4. (SBU) Bergara acknowledged that the inflation rate in recent months has been too close to the GOU's self-imposed 10 percent limit to give the GOU room to maneuver. If year-over-year inflation rises above 10 percent, it would trigger biannual salary and pension adjustments, costs which comprise a large portion of Uruguay's public expenditures. These adjustments would put additional upward pressure on the inflation rate. Bergara described the ten percent ceiling as a psychological barrier as well, stating that the government had to set an upward limit at some point and that Uruguayans had quickly become accustomed to single-digit inflation rates, compared to the often soaring inflation figures of the past.

¶5. (SBU) Some business leaders have criticized the government for focusing too much on fighting inflation at the expense of competitiveness through a weaker peso, a perspective Bergara described as myopic. Instead, he argued that that price stability is essential to achieve competitiveness and that exchange rate fluctuations provide only an ephemeral advantage. Brazil, however, can afford to depreciate and has the luxury that much of its consumer price index (CPI) basket of goods is domestically manufactured and priced in reales. Nearly half of the items in Uruguay's CPI are tied to the U.S. dollar, making changes in the exchange rate a big problem - if the dollar goes up 10 percent, the CPI would automatically increase about 5 percent.

UPCOMING INTENATIONAL MEETINGS

¶6. (SBU) Bergara will attend the Inter-American Development Bank meeting in Medellin, together with Minister of Economy Alvaro Garcia, and looks forward to meeting USG officials in attendance. He said Garcia also plans to attend the World Bank and IMF meetings this spring. Bergara also encouraged the new Treasury Secretary to continue meeting with "like-minded" Latin American ministers, meetings he said would provide opportunities for valuable exchange. Peru, Colombia, Chile and even Mexico (despite having very different economic circumstances) were important partners, along with the international banks, for Uruguay to discuss economic policy.

URUGAUY TAPS INTO CREDIT LINES

¶7. (SBU) On February 16, Uruguay applied for a USD 200 million loan from the Andean Development Corporation (CAF in Spanish). Central Bank contacts told Emboff the money would be used for debt management. Uruguay pays an average of 9 percent interest on its foreign debt; the CAF loan is substantially lower at LIBOR minus points (currently about 1.2 percent). At the same time, the GOU announced it has secured access to a USD 400 million line of credit with the World Bank.

COMMENT

¶8. (SBU) COMMENT: In November 2008, Bergara returned to the Central Bank from his previous role as Vice Minister of Economy, and has been intimately involved in GOU economic and fiscal policy. He was comfortable addressing points of difference with the business community. While he has no doubt that Uruguay will be further impacted by the global economic downturn, Uruguay's economic policies appear targeted to Uruguay's specific exposures. Post believes high-level bilateral meetings with the Uruguayan economic team in Medellin and during the World Bank/IMF meetings in Washington will send a strong message to reinforce Uruguay's pragmatic policies. End Comment.

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